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Federal Communications Commission
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FILE

In the Matter of)
)
Petition for Rulemaking to)
Modify the Regulatory Treatment of)
COMSAT World Systems' Multi-Year)
Fixed-Price Carrier-to-Carrier)
Contract-Based Switched-Voice)
Services)

RM-7913

REPLY OF
COMMUNICATIONS SATELLITE CORPORATION

COMMUNICATIONS SATELLITE CORPORATION
COMSAT World Systems

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April 28, 1992

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SUMMARY

The majority of parties filing comments on COMSAT's petition support initiation of a rulemaking proceeding looking toward the implementation of incentive-based regulation for COMSAT's multi-year carrier switched-voice services. The only outright opponents of our request are MCI, which has a long history of opposition to incentive regulation, and PanAmSat, which has a long history of opposition to anything that COMSAT proposes. Extensive interest in such a rulemaking was also forthcoming from Capitol Hill.

None of the commenting parties has seriously challenged the basis premise of COMSAT's petition: that incentive-based regulation is superior to "cost-plus" regulation. However, some have expressed doubts regarding the degree to which existing competition provides a basis for the specific relief requested by COMSAT. These doubts are misplaced. COMSAT has demonstrated the full extent to which it is subject, now and in the future, to competition from fiber optic cables and separate satellite systems in the provision of multi-year carrier switched-voice services. In addition, COMSAT has demonstrated that its major carrier customers possess enormous bargaining power in relation to COMSAT in the multi-year switched-voice market. In this regard, COMSAT's successive price reductions over the past five years do not reflect the behavior of a supplier with market power over captive customers; to the contrary, these reductions are a positive reaction to marketplace forces.

Some of the commenting parties have also raised concerns about COMSAT's ability to cross-subsidize if incentive-based regulation is adopted for its multi-year carrier switched-voice services. These concerns are without foundation. Marketplace forces do not and would not permit COMSAT either to cross-subsidize multi-year carrier switched-voice services with video and IBS services (as argued by IDB and the Networks) or to cross-subsidize other services with multi-year carrier switched-voice services (as argued by PanAmSat). Indeed, the fact that concerns were raised regarding cross-subsidization in both directions is itself compelling evidence that COMSAT faces competition for all of its services.

Finally, some of the commenting parties have asserted that incentive regulation for COMSAT must be accompanied by the full panoply of requirements that were imposed on AT&T and the LECs. However, full-blown price cap regulation is not required in the case of COMSAT, and COMSAT does not support a rulemaking mired in such proposals. Unlike AT&T and the LECs, COMSAT faces extensive competition, so it is not necessary for incentive-based regulation to replicate marketplace forces that do not otherwise exist. Rather, all that is required is to align COMSAT's regulatory regime with existing marketplace forces in a manner that will allow those forces to operate freely and effectively.

TABLE OF CONTENTS

	Page
INTRODUCTION.....	1
I. COMSAT IS SUBJECT TO PERVASIVE COMPETITION.....	3
A. COMSAT Is Competing in a Changed Marketplace	3
B. The Major Carriers Have Enormous Bargaining Power in Relation to COMSAT.....	6
II. COMSAT WILL NOT BE ABLE TO ENGAGE IN CROSS- SUBSIDIZATION.....	12
III. COMSAT DOES NOT REQUIRE FULL-BLOWN PRICE CAP REGULATION.....	14
CONCLUSION.....	15

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Communications Satellite Corporation ("COMSAT") hereby
replies to the comments and oppositions filed in response to the
above-captioned Petition for Rulemaking.¹

In its petition, COMSAT asked the Commission to replace traditional "cost-plus" rate base regulation with "incentive-based" regulation of its multi-year fixed-price carrier-to-carrier contract-based switched-voice services (hereafter "multi-year carrier switched-voice services"). Specifically, COMSAT proposed: (1) that its rates for these services be capped at the reduced rates that went into effect on January 1, 1992; (2) that

1 The following parties filed comments: Aeronautical Radio, Inc. ("Arinc"); American Telephone and Telegraph Company ("AT&T"); Capital Cities/ABC, CBS, NBC and TBS (collectively, "the Networks"); GTE Hawaiian Telephone Company ("GTE/HTC"), IDB Communications Group, Inc. ("IDB"); and Sprint Communications Company, L.P. ("Sprint"). Oppositions were filed by MCI Telecommunications Corporation ("MCI") and Pan American Satellite ("PanAmSat").

it be allowed to file further rate reductions for these services on 14 days' notice, which rates would be considered prima facie lawful as long as they covered COMSAT's average variable costs; and (3) that it be subject to the Title II complaint process, but not to annual rate-of-return reviews, with respect to these services.²

While COMSAT believes that recent marketplace developments justify much more extensive deregulation of its activities, COMSAT intentionally framed its request for regulatory relief narrowly. Specifically, in an effort to avoid the lengthy proceeding that a request for broad-based deregulation would entail, COMSAT limited its request to seeking a modest reform in the regulation of its multi-year carrier switched-voice services. As shown in the petition, and discussed more fully below, COMSAT's customers for these services are fully capable of protecting their own interests without regulatory intervention.

The majority of parties support a rulemaking to consider COMSAT's proposal. In addition, extensive interest in such a rulemaking was forthcoming from Capitol Hill.³ The only outright opponents of the petition are MCI, which has a long history of

² COMSAT Petition at 4-5.

³ More than twenty Congressional letters have been received by the Commission on this subject, urging that fair consideration be given to the extension of incentive-based regulation to COMSAT's multi-year carrier switched-voice services.

opposition to incentive regulation, and PanAmSat, which has a long history of opposition to anything that COMSAT proposes. Moreover, key COMSAT customers (including AT&T, Sprint, GTE/HTC and the Networks) all support some form of incentive regulation for COMSAT -- although, except for GTE/HTC, each argues that there should be modifications to COMSAT's specific proposal. In response to these suggested modifications, the following paragraphs will demonstrate that COMSAT's plan as proposed will fully protect the public interest.

I. COMSAT IS SUBJECT TO PERVASIVE COMPETITION.

In its petition for rulemaking, COMSAT demonstrated: (1) that incentive regulation is superior to rate-base regulation for all carriers, including COMSAT, and (2) that in COMSAT's case, a simplified form of incentive regulation will serve the public interest because COMSAT is subject to pervasive competition. None of the commenters has seriously challenged the first of these points, and while some have challenged the second point, none has done so persuasively, as the following discussion will show.

A. COMSAT Is Competing in a Changed Marketplace.

In demonstrating that it is subject to extensive competition, COMSAT pointed first to the deployment of fiber optic cables and separate satellite systems.⁴ Several parties

⁴ Petition at 6-14.

assert that such systems do not yet provide COMSAT with effective competition.⁵ By referring only to the cables and satellite systems in operation today, these commenters have attempted to camouflage, and thus to minimize, the degree of competitive pressure that COMSAT faces. Yet, even at present levels, it is clear that COMSAT does face substantial competition from other transmission systems.⁶ Moreover, as these parties well know, COMSAT is competing today for traffic that will not come on line for some years in the future. In particular, decisions as to the building of additional undersea fiber optic cables are being made now, and decisions as to the loading of cables (and satellites) currently under construction have, for the most part, already been made.

MCI's attempt to downplay the true extent of COMSAT's competition by listing countries not yet directly served by undersea fiber is unconvincing. While a number of such countries can be identified, one look at MCI's list is sufficient to prove COMSAT's point that all of the major routes are already being served.⁷ Moreover, undersea cables do not serve only those countries in which they have landing points. To the contrary,

⁵ MCI at 6-10; IDB at 3-5; PanAmSat at 2-5; Networks at 6-7.

⁶ According to press accounts, a report from Kessler Marketing Intelligence indicates that there are now 70 undersea fiber cables in place, with another 51 planned for the period 1992-97. TE&M (April 1, 1992).

⁷ MCI at Attachment A; see COMSAT Petition at 9.

there is a large and growing market for transit service via cable and microwave facilities.

As recent Commission authorizations show, various combinations of undersea fiber, terrestrial fiber, and terrestrial microwave are increasingly being utilized for transoceanic service. Sprint, for example, has been authorized to provide services between the U.S. and Czechoslovakia by leasing capacity on TAT-8 between the U.S. and France and then using digital terrestrial facilities to reach Czechoslovakia.⁸ Similarly, AT&T has been authorized to provide service between the U.S. and Costa Rica, Honduras and Nicaragua by using landline microwave circuits between the U.S. and Mexico and then using additional landline microwave circuits to reach the three Central American countries.⁹ These, of course, are just illustrations of cable and/or microwave transiting; many more could be cited. Also of note, AT&T recently referenced indirect routing arrangements and incentives to engage in third-country routing in raising concerns about the Commission's NPRM proposing to subject foreign-owned carriers to dominant carrier regulation only on routes where foreign affiliates have the ability to discriminate

⁸ US Sprint Communications Company, 7 FCC Rcd 1301 (1992).

⁹ American Telephone and Telegraph Company, DA 92-438 (released April 14, 1992).

against non-affiliated U.S. carriers.¹⁰ For all these reasons, it is wholly misleading for commenters to describe COMSAT's competition solely in terms of direct undersea cable links.

With regard to competition from separate systems, while each separate system is today limited to the provision of 100 64 KB equivalent switched-voice circuits,¹¹ it is virtually certain that the 100 circuit threshold will be increased at the next INTELSAT Assembly of Parties in November 1992, and will be raised even higher by subsequent Assemblies.¹² Thus, the level of competition from separate systems for switched-voiced services will increase in the near term on thin as well as thick routes, while cables continue their global proliferation as well.

B. The Major Carriers Have Enormous Bargaining Power in Relation to COMSAT.

In its petition, COMSAT pointed out that the major carriers have tremendous bargaining power and influence in their negotiations with COMSAT because of their ownership of fiber optic cables and the absence of any circuit distribution

¹⁰ Comments of AT&T in CC Docket No. 91-360 at 17-18 (February 26, 1992).

¹¹ Letter from James A. Baker, III and Robert Mosbacher to Alfred C. Sikes (Nov. 27, 1991); Letter from Thomas J. Murrin and Lawrence S. Eagleburger to Alfred C. Sikes (Dec. 14, 1990).

¹² See, e.g., BG-92-68 (Report of the Article XIV(d) Working Party to the Board of Governors, Feb. 20, 1992); BG-92-82 (Report of the Working Party to the Board of Governors on the Review of the Article XIV(d) Non-technical Assessment Procedures, Mar. 10, 1992).

(loading) guidelines.¹³ The Commission has explicitly recognized that these factors have put COMSAT under substantial competitive pressure,¹⁴ yet, in response, both AT&T and MCI claim that COMSAT possesses market power over them.¹⁵ As evidence of this alleged market power, both carriers cite their existing contractual agreements with COMSAT and COMSAT's current rate structure for digital circuits. Below, we address each of these matters and demonstrate beyond doubt that the market power in this relationship rests with the major carriers and not with COMSAT.

Both the AT&T and MCI Agreements were the product of extended negotiations lasting several months -- and the parties so stated when the two agreements were presented to the Commission.¹⁶ Now, however, the carriers seek to portray their agreements with COMSAT in another light. These claims are

¹³ Petition at 9. The major carriers' bargaining power is also enhanced by their sheer size relative to COMSAT and the fact that so few of them account for such a large share of COMSAT's total traffic and revenues. Thus, far from possessing a monopoly as some commenters insist, COMSAT is really faced with an oligopsony -- that is, a market situation in which each of a few buyers exerts a disproportionate influence on the market.

¹⁴ Policy for the Distribution of United States International Carrier Circuits Among Available Facilities During the Post-1988 Period, 3 FCC Rcd 2156, 2162 (1988); see also Kwerel and McNally, Promoting Competition Between International Telecommunications Cables and Satellites, OPP Working Paper No. 19 (January 1986).

¹⁵ AT&T at 3; MCI at 4,9. Sprint also asserts that COMSAT retains some market power. Sprint at 2.

¹⁶ Joint Supplemental Comments of COMSAT and AT&T in CC Docket No. 87-67 (October 9, 1987) at 1; Letter from COMSAT and MCI to FCC (November 1, 1988) at 1.

totally without merit. Although AT&T now describes its agreement as a "legacy of regulatory prescription" which "shares some of the infirmities of the prior regime,"¹⁷ its view at the time the agreement was negotiated was that the agreement reflected the parties' "joint efforts to remove from the regulatory arena issues relating to AT&T's utilization of COMSAT's INTELSAT space segment capacity." Indeed, AT&T joined with COMSAT in declaring that the Agreement, once approved by the Commission, would "substitute marketplace forces for regulatory actions in this important area of international communications."¹⁸ For its part, MCI claims that it had little choice but to enter into a contract with COMSAT "if it wanted to remain cost-competitive with AT&T."¹⁹ However, the fact is that the rates provided to AT&T in its Agreement with COMSAT were also made available to MCI (and all other COMSAT customers) pursuant to tariff.²⁰ Thus, MCI could have remained cost-competitive with AT&T without making any specific contractual commitment to COMSAT at all.

The carriers and PanAmSat also contend that the AT&T and MCI contracts insulate COMSAT from competition because they have

¹⁷ AT&T at 3, 5.

¹⁸ COMSAT-AT&T Agreement, Art. II (emphasis added); see also Joint Supplemental Comments, supra, at 3-4.

¹⁹ MCI at 9.

²⁰ COMSAT Transmittal No. 674, filed November 20, 1987.

enabled COMSAT to "lock in" its largest customers.²¹ In the first place, the very purpose of a long-term contract is to provide lower prices in exchange for a multi-year commitment. More importantly, while it is true that a very large proportion of COMSAT's existing traffic is now under long-term contract, the only additional voice traffic that is committed to COMSAT under contract is 30% of AT&T's growth traffic through mid-1995.²² After that, neither AT&T nor any other customer has any obligation to place even a single additional circuit with COMSAT.

This intense competition has led COMSAT to reduce its prices substantially and repeatedly, even for circuits that have already been committed and/or activated pursuant to the AT&T and MCI agreements. The COMSAT-AT&T Agreement provided that COMSAT's rates for 10-year 64 KB circuits would be no higher than \$875 per month through 1992, and would then decline to no more than \$825 in 1993 and \$800 in 1994.²³ The COMSAT-MCI Agreement specified the same rates for 15-year commitments, and extended the \$800 ceiling through 1998.²⁴ If those agreements had truly given COMSAT the ability to price "supra-competitively," as AT&T

²¹ MCI at 15; see also AT&T at 3, 7; PanAmSat at 4-5, 6.

²² See COMSAT-AT&T Agreement, Art. V. MCI has already met all of its traffic commitments under its existing Agreement with COMSAT.

²³ COMSAT-AT&T Agreement, Art. X.

²⁴ COMSAT-MCI Agreement, Art. X. MCI also received a temporary up-front reduction in consideration of its 15-year commitment.

contends,²⁵ or had given COMSAT "enormous pricing power" as MCI contends,²⁶ COMSAT clearly would have been able to maintain its prices at the \$875 level through year-end 1992. Instead, COMSAT has twice reduced its standard rates, and has also had three short-term rate reductions, as reflected below.

In 1990, COMSAT reduced its standard 10-year rate from \$875 to \$770 per month and introduced a 15-year rate of \$726 per month.²⁷ Then, in 1991, COMSAT reduced its standard 10 and 15-year rates for "base" circuits activated through December 1991 to \$695 and \$650 per month, respectively, and further reduced its rates for 10 and 15-year "growth" circuits activated after that date to as little as \$350 and \$305 per month, depending on traffic volumes.²⁸ As a result of these reductions, AT&T's average cost per satellite circuit in 1992 is almost 25% lower than what it bargained for in 1987, and MCI's average cost per circuit is almost 30% lower than what it bargained for in 1988. Moreover, those percentages increase with every new circuit that the two carriers add.

²⁵ AT&T at 7.

²⁶ MCI at 9.

²⁷ COMSAT Transmittal No. 792, filed June 4, 1990. The rates quoted were for 64 KB equivalent circuits in a 2.048 MB carrier.

²⁸ COMSAT Transmittal No. 908, filed November 20, 1991. MCI unaccountably claims (at 15) that COMSAT's "growth incentive" rates are available exclusively to "newer" customers. This is not true.

Not satisfied with these unilateral rate reductions, AT&T and MCI attack COMSAT's current rate structure which, as noted above, differentiates between "base" and "growth" circuits. Although neither carrier objected to this rate structure at the time it was filed, each now claims that the structure is another product of COMSAT's alleged market power.²⁹ In fact, exactly the opposite is true. Before filing its current tariff, COMSAT negotiated with both AT&T and MCI for several months, and in those negotiations it repeatedly offered the carriers substantial rate reductions in exchange for additional commitments to place specified amounts of growth traffic on the INTELSAT system. Both AT&T and MCI refused to make any additional growth commitments. Nevertheless, COMSAT went ahead and tariffed significant reductions, not only for growth traffic, but for base traffic already committed to the system.

This simply is not the behavior of a supplier with market power over "captive customers."³⁰ To the contrary, this history demonstrates that both AT&T and MCI have market power over COMSAT which, in effect, has enabled them to renegotiate their contracts. Now, both AT&T and MCI are attempting to use this proceeding as further leverage against COMSAT, by arguing that COMSAT's failure to make even more unilateral concessions is

²⁹ MCI at 4; AT&T at 3-4.

³⁰ MCI at 3.

evidence of COMSAT's market power. This is nothing more than an attempt to enlist the Commission's aid in capitalizing further on the carriers' favorable negotiating position, and is one more reason why COMSAT deserves the modest regulatory relief that it has requested.³¹

II. COMSAT WILL NOT BE ABLE TO ENGAGE IN CROSS-SUBSIDIZATION.

In addition to questioning whether COMSAT faces effective competition, several commenters express concern over the possibility that the implementation of incentive-based regulation would permit COMSAT to cross-subsidize between services. These fears are based on the belief that, because of competition, COMSAT has incentives to cross-subsidize. However, as discussed below, any such incentives are outweighed by other incentives, and COMSAT has no ability to cross-subsidize in any event.

Significantly, the parties disagree as to just which way such cross-subsidies might run. The Networks and IDB assert that

³¹ Arinc's comments reflect an even less subtle attempt to use COMSAT's petition as a vehicle to force concessions in the marketplace. Like AT&T and MCI, Arinc has a multi-year fixed-price contract with COMSAT -- but that contract is with COMSAT Mobile Communications, not with COMSAT World Systems, and is wholly unrelated to the present petition. In any event, the reductions in INMARSAT utilization charges to which Arinc refers do not, and should not, provide a basis for renegotiating Arinc's contract. As the Commission has recognized, INTELSAT (and Inmarsat) utilization charges are not a true measure of COMSAT's costs. See Regulatory Policies Concerning Direct Access to INTELSAT Space Segment for the U.S. International Service Carriers, 97 FCC 2d 296, 316 (1984), aff'd, Western Union International, Inc. v. FCC, 804 F.2d 1280 (D.C. Cir. 1986).

the market for multi-year carrier switched-voice services is so competitive that COMSAT might try to subsidize it with services (such as video and IBS) that would remain subject to traditional regulation,³² while PanAmSat asserts that just the opposite is true.³³ These contrasting views can be explained, of course, by the different interests of the commenters. As video and IBS customers, the Networks and IDB are interested in keeping COMSAT's prices for those services low, while as COMSAT's main competitor in those areas, PanAmSat's interest is exactly the opposite. In any event, both sides' arguments are wrong, because COMSAT will not be able to cross-subsidize in either direction.

Turning first to the concerns of the Networks and IDB, it is clear that COMSAT will not be able to cross-subsidize multi-year carrier switched-voice services with video and IBS services. As shown in COMSAT's petition, the latter services are fully subject to competition from separate systems and, in the case of IBS, from fiber optic cables as well. Moreover, these services are projected to be the fastest growing part of COMSAT's future business, so it would be futile and short-sighted for COMSAT to attempt to overcharge its video and IBS customers.

While COMSAT's video and IBS customers do not have the obvious market power of the major IMTS carriers, they do have a

³² Networks at 5-9; IDB at 3.

³³ PanAmSat at 9-10.

choice among competing suppliers. And since these services will remain subject to traditional regulation, at least for the time being, COMSAT's customers will be able to take full advantage of the Commission's processes (including the tariff review process) in order to protect themselves from any possibility of cross-subsidization. Finally, multi-year switched-voice services still comprise by far the largest portion of COMSAT's business, so even if COMSAT could overcharge its video and IBS customers, that would not produce enough revenue to underwrite the switched-voice business. For all the above reasons, COMSAT will not be able to cross-subsidize multi-year carrier switched-voice services with revenues from other services.

As for PanAmSat's counterargument, it is clear from Part I above that COMSAT also will not be able to cross-subsidize other services with the revenues from multi-year switched-voice services. The major carriers simply would not tolerate it, and would promptly take their business elsewhere. However, COMSAT does not expect the Commission, or the parties, to take these assurances on faith. Rather, it expects that the Commission will insist on the development of adequate cost allocation procedures as part of any future rulemaking proceeding.

III. COMSAT DOES NOT REQUIRE FULL-BLOWN PRICE CAP REGULATION.

Finally, a number of parties have asserted that any move toward incentive-based regulation for COMSAT must be accompanied

by some or all of the requirements that were imposed on AT&T and the LECs as part of their "price cap" regimes.³⁴ As COMSAT explained in its petition, however, the price cap regulation applied to AT&T and the LECs, with its productivity factors, exogenous cost formulae and so forth, is a means of replicating marketplace forces where they do not exist. In COMSAT's case, the marketplace can and will work, if only given the chance. Therefore, none of these complicating factors is necessary, and their imposition would actually interfere with the proper workings of the market.³⁵

CONCLUSION

The Commission has been presented with a number of issues, some of which are legitimate, but many of which are not. For the

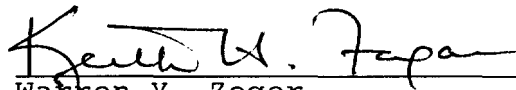
³⁴ AT&T at 4; MCI at 17-18; Sprint at 2. Some of the carriers' proposals are more extreme than others. AT&T, for example, argues that the Commission should prescribe COMSAT's initial price caps in a proceeding under Section 205 of the Communications Act, and should also establish "appropriate refund and sharing mechanisms" for COMSAT. Of course, none of these requirements was ever imposed on AT&T itself; they were only imposed on the LECs. Perhaps, before seeking to place such burdens on COMSAT, AT&T should explain why it should not also be subject to these requirements.

³⁵ IDB asserts that COMSAT has failed to explain why incentive regulation is either necessary or desirable if (as COMSAT has argued) COMSAT is already subject to marketplace forces. IDB at 5. However, it neither makes sense to have COMSAT's regulatory incentives working at cross-purposes with its marketplace incentives, nor for regulation to impede COMSAT's ability to offer its customers the lowest possible rates, as is the case with "cost-plus" regulation. Thus, contrary to IDB's suggestion, incentive regulation is both necessary and desirable.

reasons stated above and in COMSAT's petition, it is not necessary to encumber COMSAT with all the trappings of price cap regulation as applied to AT&T and the LECs. Accordingly, the Commission should issue a notice of proposed rulemaking proposing simplified incentive regulation for COMSAT's multi-year carrier switched-voice services.

Respectfully submitted,

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A handwritten signature in dark ink, appearing to read "Keith H. Fagan", is written over a horizontal line.

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